

Trade & Customs - USA

Congressional Focus on Export Controls May Lead to Greater Domestic Sales Scrutiny

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US companies should expect enhanced export enforcement activities focusing on domestic sales as the result of a recent undercover investigation by the Government Accountability Office (GAO). The investigation, summarized in a GAO report published on June 4 2009,⁽¹⁾ showed that exporting both military and dual-use products and technologies to restricted destinations remains surprisingly simple, despite US export controls. With congressional and administrative interest focused on the control of sensitive items and technologies on the rise, US companies should review their screening and 'know your customer' procedures, even for domestic sales. Companies should also be prepared for increased industry outreach by law enforcement agencies and requests to participate in 'sting' operations.

On June 4 2009 GAO officials testified before a congressional subcommittee regarding a year-long undercover investigation that targeted US companies selling products with a known risk of diversion to end uses prohibited by US export controls (eg, nuclear proliferation and missile development). The GAO used a fake US front company, a fictitious company website and rented domestic commercial mailboxes to purchase 12 military or dual-use products from US manufacturers and distributors. The products chosen had all been the subject of recent prosecutions for export control violations, priced from under \$100 to over \$7,500, and included:

- gyro chips;
- night-vision monoculars or goggles;
- accelerometers;
- triggered spark gaps;
- oscilloscopes;
- quadruple differential line receivers;
- inclinometers;
- Ka-band power amplifiers;
- infra-red flags; and
- modular tactical vests and enhanced small arms protective inserts.

The GAO succeeded in all the attempted purchases (although ultimately did not consummate some of them due to inordinate cost or previous success acquiring the same product). The GAO also successfully obtained price quotes for large quantities of certain sensitive products. Upon receipt of several purchased products, the GAO mailed inoperative versions to countries that are known transshipment points for terrorist organizations.

GAO officials acknowledged that the companies targeted by the investigation had not violated US export control laws by selling the sensitive products to the US front company. Although US export controls regulate the international sale of these products, there are no comparable restrictions on their domestic sale. Unless a US company is aware that a product sold to another domestic entity will subsequently be exported, the seller is not liable for export control violations by the purchaser. Citing this weak regulatory structure, as well as poor coordination between the agencies charged with administering US export controls, the GAO recommended that Congress fundamentally re-examine how critical technologies are protected by US law.

The Bureau of Industry and Security, one of the agencies charged with administering US export controls, offered its views to the congressional subcommittee on the difficulty of preventing the illegal export of sensitive products after they are legally sold to domestic buyers. The bureau highlighted the importance of 'preventive enforcement' in confronting the weakness exposed by the GAO investigation. It indicated that its 'know

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your customer' guidelines and list of Red Flag indicators are intended to elicit industry cooperation in conducting due diligence – including with respect to domestic customers. The bureau also highlighted recent successes in collaborating with US industry to conduct a 'controlled delivery', which involved shipping inoperative controlled products and arresting purchasers attempting to send these products out of the United States. The bureau explained that it relies on the cooperation of US industry to identify domestic procurement networks working on behalf of terrorist organizations and other prohibited parties.

The GAO testimony to Congress on the results of its covert investigation is likely to spark even greater government interest in the control of sensitive technologies. Although a legislative solution extending export control requirements to domestic sales is unlikely in the short term (and unpopular with industries facing competitiveness concerns), US law enforcement authorities are expected to increase industry outreach. US companies should expect more frequent visits from the Bureau of Industry and Security and other agencies involved in export control enforcement, such as the Federal Bureau of Investigation, Immigration and Customs Enforcement and the Naval Criminal Investigative Service. Requests for cooperation with government investigations, such as through the production of sales records, may also increase. If such sales records reveal that a US company has been contacted by a suspected front company or transshipper, the US company can expect to be asked to cooperate by participating in a controlled delivery as the basis for a criminal prosecution.

Therefore, US companies should prepare themselves for this likely increase in outreach. In particular, companies should consider whether their internal compliance procedures with respect to domestic sales effectively minimize the risk of product diversion for illegal export. Voluntary implementation of enhanced compliance procedures for domestic sales may reduce the likelihood of government outreach by protecting a company from inadvertent sales to domestic parties intent on illegal export.

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Endnotes

(1)

www.sidley.com/files/News/eedbf867-4258-4ac9-93a6-3aead553bf96/Presentation/NewsAttachment/3930fae0-b614-4575-940a-3b502:

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